

# 18

ACCOUNTING POLICIES

FINANCIAL REPORTING  
STANDARD



ACCOUNTING  
STANDARDS  
BOARD

*Financial Reporting Standard 18  
'Accounting Policies' is issued by the  
Accounting Standards Board in respect  
of its application in the United Kingdom  
and by the Institute of Chartered  
Accountants in Ireland in respect of its  
application in the Republic of Ireland.*

# 18

## ACCOUNTING POLICIES



ACCOUNTING  
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*Financial Reporting Standard 18 is set out in paragraphs 1–69.*

*The Statement of Standard Accounting Practice, which comprises the paragraphs set in bold type, should be read in the context of the Objective as stated in paragraph 1 and the definitions set out in paragraphs 4 and 5 and also of the Foreword to Accounting Standards and the Statement of Principles for Financial Reporting currently in issue.*

*The explanatory paragraphs contained in the FRS shall be regarded as part of the Statement of Standard Accounting Practice insofar as they assist in interpreting that statement.*

*Appendix IV ‘The development of the FRS’ reviews considerations and arguments that were thought significant by members of the Board in reaching the conclusions on the FRS.*

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## **ADOPTION OF FRS 18 BY THE BOARD**

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## **SUMMARY**

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- a Financial Reporting Standard 18 sets out the principles to be followed in selecting accounting policies and the disclosures needed to help users to understand the accounting policies adopted and how they have been applied.
- b The FRS defines accounting policies, and estimation techniques used in implementing those policies. Accounting policies should be consistent with accounting standards, Urgent Issues Task Force (UITF) Abstracts and companies legislation. Where this requirement allows a choice, the FRS requires an entity to select those accounting policies judged to be most appropriate to its particular circumstances for the purpose of giving a true and fair view.
- c An entity should judge the appropriateness of accounting policies to its particular circumstances against the objectives of relevance, reliability, comparability and understandability. The constraints that an entity should take into account are the need to balance the different objectives, and the need to balance the cost of providing information with the likely benefit of such information to users of the entity's financial statements.
- d An entity's accounting policies should be reviewed regularly to ensure that they remain the most appropriate to its particular circumstances. An entity should implement a new accounting policy if it is judged more appropriate to the entity's particular circumstances than the present accounting policy.

- e The FRS requires specific disclosures about the accounting policies followed and changes to those policies. It also requires, in some circumstances, disclosures about the estimation techniques used in applying those policies.



## **FINANCIAL REPORTING STANDARD 18**

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### **OBJECTIVE**

- 1 The objective of this FRS is to ensure that for all material items:
  - (a) an entity adopts the accounting policies most appropriate to its particular circumstances for the purpose of giving a true and fair view;
  - (b) the accounting policies adopted are reviewed regularly to ensure that they remain appropriate, and are changed when a new policy becomes more appropriate to the entity's particular circumstances; and
  - (c) sufficient information is disclosed in the financial statements to enable users to understand the accounting policies adopted and how they have been implemented.

### **SCOPE**

- 2 **The FRS applies to all financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period.**
- 3 **Reporting entities applying the Financial Reporting Standard for Smaller Entities currently applicable are exempt from the FRS.**

## DEFINITIONS

- 4 The following definitions shall apply in the FRS and in particular in the Statement of Standard Accounting Practice set out **in bold type**.

### *Accounting policies:-*

Those principles, bases, conventions, rules and practices applied by an entity that specify how the effects of transactions and other events are to be reflected in its financial statements through

- (i) recognising,
- (ii) selecting measurement bases for, and
- (iii) presenting

assets, liabilities, gains, losses and changes to shareholders' funds. Accounting policies do not include estimation techniques.

Accounting policies define the process whereby transactions and other events are reflected in financial statements. For example, an accounting policy for a particular type of expenditure may specify whether an asset or a loss is to be recognised; the basis on which it is to be measured; and where in the profit and loss account or balance sheet it is to be presented.

### *Estimation techniques:-*

The methods adopted by an entity to arrive at estimated monetary amounts, corresponding to the measurement bases selected, for assets, liabilities, gains, losses and changes to shareholders' funds.

Estimation techniques implement the measurement aspects of accounting policies. An accounting policy will specify the basis on which an item is to be measured; where there is uncertainty over the monetary amount corresponding to that basis, the amount will be arrived at by using an estimation technique.

Estimation techniques include, for example:

- (a) methods of depreciation, such as straight-line and reducing balance, applied in the context of a particular measurement basis, used to estimate the proportion of the economic benefits of a tangible fixed asset consumed in a period;
- (b) different methods used to estimate the proportion of trade debts that will not be recovered, particularly where such methods consider a population as a whole rather than individual balances.

*Measurement bases:-*

Those monetary attributes of the elements of financial statements—assets, liabilities, gains, losses and changes to shareholders’ funds—that are reflected in financial statements.

Where a business holds an asset that was purchased, the asset will have a number of qualities that may be expressed in terms of ‘values’. As well as the amount for which it was acquired, it will have a current net realisable value and, if it is capable of being replaced, it will have a current replacement cost. These are examples of monetary attributes of the asset. Other examples arise when different monetary attributes are combined in a formula. For example, in a historical cost system, stocks are stated at the lower of historical

cost and net realisable value. Similarly, in a current value measurement system, the current value of an asset, using the value to the business rule, is the lower of replacement cost and recoverable amount.\*

Monetary attributes fall into two broad categories—those that reflect current values and those that reflect historical values. Some monetary attributes will be suitable for use in financial statements only in conjunction with others.† A monetary attribute, or combination of attributes, that may be reflected in financial statements is called a measurement basis.

### *SORP:-*

An extant Statement of Recommended Practice (SORP) either developed in accordance with the Board's policy on SORPs, and including a statement by the Board,‡ or 'franked' by the former Accounting Standards Committee.

SORPs recommend accounting practices for specialised industries or sectors. They supplement accounting standards and other legal and regulatory requirements in the light of the special factors prevailing or transactions undertaken in a particular industry or sector.

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\* Recoverable amount is itself the higher of value in use and net realisable value.

† For example, value in use is unlikely to be appropriate for use in financial statements unless the competing claims of alternative monetary attributes are also considered, as in the value to the business rule.

‡ The Statement 'SORPs: Policy and Code of Practice' sets out the Board's policy on SORPs and the basis on which a SORP will include a statement by the Board.

- 5 References to companies legislation mean, for a company:
- (a) in Great Britain, the Companies Act 1985;
  - (b) in Northern Ireland, the Companies (Northern Ireland) Order 1986; and
  - (c) in the Republic of Ireland, the Companies Acts 1963–90 and the European Communities (Companies: Group Accounts) Regulations 1992;
- and for an entity other than a company, any equivalent legislation.

## **APPLYING THE DEFINITIONS IN PRACTICE**

### ***Distinguishing accounting policies from estimation techniques***

- 6 Often, accounting standards or companies legislation will prescribe the measurement bases to be used in respect of particular assets and liabilities. Whether prescribed or selected, measurement bases are a matter of accounting policy. Accordingly, if an entity has previously reported certain assets on a historical cost basis, but now reports them on a current value basis, that is a change of accounting policy.
- 7 By contrast, the choice of method used to arrive at a monetary amount corresponding to a measurement basis is not a matter of accounting policy. For example, an entity may wish to measure the current disposal value of an asset. It might estimate this by reference to its own recent disposals of similar assets, or by reference to prices quoted in advertisements. Both methods are intended to arrive at the same unknown figure, and therefore a change from one

method to another is a change of estimate, not of accounting policy. These methods are referred to in the FRS as estimation techniques.

- 8 Financial statements present information about their elements—assets, liabilities, gains, losses and changes to shareholders’ funds—but not all the information that is available can be presented in an entity’s primary financial statements. For example, although information may be available about two different monetary attributes of a particular asset—its historical cost and its current value under the value to the business rule—it will not be possible to reflect both in the entity’s balance sheet. Therefore, accounting policies are used to determine which information is to be presented—ie which attribute of the asset is to be measured—and also how it is to be presented. By contrast, where it is either impossible or impractical to measure directly the amount corresponding to that attribute, estimation techniques are used to arrive at a suitable approximation. In simple terms, accounting policies determine which facts about a business are to be presented in financial statements, and how those facts are to be presented; estimation techniques are used to establish what those facts are. Some examples of changes to accounting policies and to estimation techniques are set out in Appendix I.

### ***Recognition***

- 9 For certain transactions, accounting standards allow a choice of what is to be recognised. Examples arise in FRS 15 ‘Tangible Fixed Assets’, which allows directly attributable interest to be treated either as part of an asset or as an expense, and in SSAP 13 ‘Accounting for research and development’, which allows expenditure satisfying asset recognition criteria to be treated either as an asset or as an expense. Where accounting standards allow a choice over what is to be recognised, that choice is a matter of accounting policy.

***Measurement bases for fungible assets***

- 10 Fungible assets are assets that are substantially indistinguishable one from another, in that there is no basis on which to distinguish between them in economic terms. Companies legislation, accounting standards and Urgent Issues Task Force (UITF) Abstracts may specify accounting policies for particular types of fungible asset. Subject to any such constraints, where fungible assets are recorded at historical cost, an entity's accounting policy may be to determine cost on an asset-by-asset basis, or the entity may select an accounting policy that considers those assets in aggregate, rather than individually. Accounting policies that consider fungible assets in aggregate will use measurement bases such as weighted average historical cost and historical cost measured on a 'first in, first out' (FIFO) basis.
- 11 However, an accounting policy that determines cost for fungible assets on an asset-by-asset basis may not enhance the comparability of financial statements. This is because the results reported under such a policy will be affected by the order in which fungible assets are disposed of or consumed, even though there is no basis on which to distinguish between those assets in economic terms. Accordingly, an accounting policy that considers fungible assets in aggregate will be more consistent with the objective of comparability set out in paragraph 30.

### *Changes to presentation*

- 12 When an entity changes the way it presents a particular item in the balance sheet or in the profit and loss account, that is a change of accounting policy. However, it is not a change of accounting policy merely to provide additional information. Accordingly, where a more detailed analysis of a particular item in the balance sheet or in the profit and loss account is presented, or where information is disclosed for the first time, that is not of itself a change of accounting policy. Nevertheless, it will still be necessary to disclose corresponding amounts in similar detail.
- 13 Care is needed when an accounting change involves both a change of presentation and a change of estimation technique. The former will be treated as a change of accounting policy but the latter will not.\*

## ACCOUNTING POLICIES

### *Accounting policies and financial statements*

- 14 **An entity should adopt accounting policies that enable its financial statements to give a true and fair view. Those accounting policies should be consistent with the requirements of accounting standards, Urgent Issues Task Force (UITF) Abstracts and companies legislation.**

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\* This is illustrated in Example 4b in Appendix I.



- 15 **If in exceptional circumstances compliance with the requirements of an accounting standard or UITF Abstract is inconsistent with the requirement to give a true and fair view, the requirements of the accounting standard or UITF Abstract should be departed from to the extent necessary to give a true and fair view. In such circumstances, the disclosures set out in paragraph 62 should be provided.**
- 16 An entity will not depart from the requirements of an accounting standard or UITF Abstract where a true and fair view can be achieved by additional disclosure. In such circumstances, the requirements of the accounting standard or UITF Abstract are not inconsistent with the requirement to give a true and fair view.
- 17 **Where it is necessary to choose between accounting policies that satisfy the conditions in paragraph 14, an entity should select whichever of those accounting policies is judged by the entity to be most appropriate to its particular circumstances for the purpose of giving a true and fair view.**
- 18 The provision of additional disclosures will not justify or remedy the adoption of an accounting policy other than that which is judged by the entity to be most appropriate to its particular circumstances for the purpose of giving a true and fair view. The appropriateness of accounting policies to an entity's particular circumstances is judged by reference to the objectives and constraints set out in paragraphs 30 and 31.

- 19 Financial statements need to reflect, in an appropriate manner and as far as is practicable, the effects of transactions and other events on an entity's financial performance and financial position. Accounting policies assist in this process by providing a framework within which elements of financial statements, such as assets and liabilities, are recognised, measured and presented. They enhance the comparability of financial statements by helping to ensure that similar transactions are reflected in a similar way.
- 20 Two concepts—the going concern assumption and accruals—play a pervasive role in financial statements, and hence in the selection of accounting policies.

*Going concern*

- 21 **An entity should prepare its financial statements on a going concern basis, unless**

**(a) the entity is being liquidated or has ceased trading, or**

**(b) the directors have no realistic alternative but to liquidate the entity or to cease trading,**

**in which circumstances the entity may, if appropriate, prepare its financial statements on a basis other than that of a going concern.**

- 22 The information provided by financial statements is usually most relevant if prepared on the hypothesis that the entity is to continue in operational existence for the foreseeable future. This hypothesis is commonly referred to as the going concern assumption. Financial statements are usually prepared on the basis that the reporting entity is a going concern because measures based on break-up values tend not to be relevant to users seeking to assess the entity's cash-generation ability and financial adaptability.

- 23 **When preparing financial statements, directors should assess whether there are significant doubts about an entity's ability to continue as a going concern.**
- 24 If the directors, when making the assessment required by paragraph 23, are aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, paragraph 61 requires them to disclose those uncertainties. In making their assessment, the directors take into account all available information about the foreseeable future.
- 25 The degree of consideration necessary to make the assessment required by paragraph 23 depends on the facts in each case. When an entity has a history of profitable operations, which are expected to continue, and ready access to financial resources, detailed analysis may not be necessary. In other cases, the directors may, in making their assessment, need to consider a wide range of factors surrounding current and expected profitability, debt repayment schedules and potential sources of replacement financing. Such considerations also govern the length of time in respect of which the assessment should be made.

*Accruals*

- 26 **An entity should prepare its financial statements, except for cash flow information, on the accrual basis of accounting.**

- 27 The accrual basis of accounting requires the non-cash effects of transactions and other events to be reflected, as far as is possible,\* in the financial statements for the accounting period in which they occur, and not, for example, in the period in which any cash involved is received or paid. The accruals concept lies at the heart of the definitions of assets and liabilities, which are set out in FRS 5 ‘Reporting the Substance of Transactions’. Accordingly, the use of those definitions to determine items to be recognised in an entity’s balance sheet is consistent with the accruals concept.

### *Realisation*

- 28 In preparing financial statements, an entity will have regard to requirements in companies legislation that only profits realised at the balance sheet date should be included in the profit and loss account. Companies legislation requires realised profits to be determined in accordance with principles generally accepted at the time that financial statements are prepared. It is generally accepted that profits shall be treated as realised, for these purposes, only when realised† in the form either of cash or of other assets the ultimate cash realisation of which can be assessed with reasonable certainty.

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\* In rare cases, it may not be possible to reflect the non-cash effects of transactions and other events in the financial statements for the accounting period in which they occur because they are not yet capable of reliable measurement. In such circumstances, recognition will be deferred until reliable measurement is possible.

† In this context, ‘realised’ may also encompass profits relating to assets that are readily realisable.

- 29 The requirements in paragraph 28 relating to realised profits and the profit and loss account apply unless there are special reasons for departing from them. However, such reasons will not exist unless, as a minimum, it is possible to be reasonably certain that, although a gain is unrealised, it nevertheless exists, and to measure it with sufficient reliability.\*

*Objectives and constraints in selecting accounting policies*

- 30 **The objectives against which an entity should judge the appropriateness of accounting policies to its particular circumstances are:**
- (a) **relevance;**
  - (b) **reliability;**
  - (c) **comparability; and**
  - (d) **understandability.**
- 31 **The constraints that an entity should take into account in judging the appropriateness of accounting policies to its particular circumstances are:**
- (a) **the need to balance the different objectives set out in paragraph 30; and**
  - (b) **the need to balance the cost of providing information with the likely benefit of such information to users of the entity's financial statements.**

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\* In addition, where there are special reasons for departing from the requirements described in paragraph 28, directors will also consider whether a departure would result in the use of valuation bases or other accounting treatments not permitted by companies legislation, which would be available only if use of the true and fair override was justified.

- 32 Although these objectives and constraints are discussed individually below, they are considered together in judging the appropriateness of accounting policies to an entity's particular circumstances.

*Relevance*

- 33 The objective of financial statements is to provide information about an entity's financial performance and financial position that is useful for assessing the stewardship of management and for making economic decisions. Financial information is relevant if it has the ability to influence the economic decisions of users and is provided in time to influence those decisions. Relevant information possesses either predictive or confirmatory value or both.
- 34 Appropriate accounting policies will result in financial information being presented that is relevant. Where more than one accounting policy would achieve this result, an entity will consider which of those policies presents the most relevant financial information in the context of the financial statements as a whole. In identifying that accounting policy, an entity will consider which measurement basis is most relevant and how to present information in the most relevant way.

*Reliability*

- 35 Financial information is reliable if:
- (a) it can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and therefore reflects the substance of the transactions and other events that have taken place;
  - (b) it is free from deliberate or systematic bias (ie it is neutral);

- (c) it is free from material error;
  - (d) it is complete within the bounds of materiality; and
  - (e) under conditions of uncertainty, it has been prudently prepared (ie a degree of caution has been applied in exercising judgement and making the necessary estimates).
- 36 Appropriate accounting policies will result in financial information being presented that is reliable. They will present transactions and other events in a way that reflects their substance. A transaction or other event is faithfully represented in financial statements if the way in which it is recognised, measured and presented in those statements corresponds closely to the effect of that transaction or event.
- 37 Often there is uncertainty, either about the existence of assets, liabilities, gains, losses and changes to shareholders' funds, or about the amount at which they should be measured. Prudence requires that accounting policies take account of such uncertainty in recognising and measuring those assets, liabilities, gains, losses and changes to shareholders' funds. In conditions of uncertainty, appropriate accounting policies will require more confirmatory evidence about the existence of an asset or gain than about the existence of a liability or loss, and a greater reliability of measurement for assets and gains than for liabilities and losses.
- 38 However, it is not necessary to exercise prudence where there is no uncertainty. Nor is it appropriate to use prudence as a reason for, for example, creating hidden reserves or excessive provisions, deliberately understating assets or gains, or deliberately overstating liabilities or losses, because that would mean that the financial statements are not neutral and therefore not reliable.

*Comparability*

- 39 Information in an entity's financial statements gains greatly in usefulness if it can be compared with similar information about the entity for some other period or point in time, and with similar information about other entities. Such comparability can usually be achieved through a combination of consistency and disclosure. The disclosures required in respect of an entity's accounting policies, and any changes to those policies, are set out in paragraph 55.
- 40 Appropriate accounting policies will result in financial information being presented in a way that enables users to discern and evaluate similarities in, and differences between, the nature and effects of transactions and other events taking place over time. In selecting accounting policies, an entity will assess whether accepted industry practices are appropriate to its particular circumstances. Such practices will be particularly persuasive if set out in a SORP that has been generally accepted by an industry or sector.

*Understandability*

- 41 Information provided by financial statements needs to be capable of being understood by users having a reasonable knowledge of business and economic activities and accounting and a willingness to study with reasonable diligence the information provided. Appropriate accounting policies will result in financial information being presented in a way that enables its significance to be perceived by such users.



*Balancing the different objectives*

- 42 There can be tensions between the different objectives set out in paragraph 30. In particular, sometimes the accounting policy that is most relevant to a particular entity's circumstances is not the most reliable, and vice versa. In such circumstances, the most appropriate accounting policy will usually be that which is the most relevant of those that are reliable.
- 43 There can also be tension between two aspects of reliability—neutrality and prudence. Whilst neutrality involves freedom from deliberate or systematic bias, prudence is a potentially biased concept that seeks to ensure that, under conditions of uncertainty, gains and assets are not overstated and losses and liabilities are not understated. This tension exists only where there is uncertainty, because it is only then that prudence needs to be exercised. In the selection of accounting policies, the competing demands of neutrality and prudence are reconciled by finding a balance that ensures that the deliberate and systematic understatement of assets and gains and overstatement of liabilities and losses do not occur.

*Cost and benefit considerations*

- 44 Paragraph 14 emphasises that accounting policies should be consistent with the requirements of accounting standards, UITF Abstracts and companies legislation. Accordingly, cost and benefit considerations will not justify the adoption of an accounting policy that is inconsistent with those requirements.

*Reviewing and changing accounting policies*

- 45 **An entity's accounting policies should be reviewed regularly to ensure that they remain the most appropriate to its particular circumstances for the purpose of giving a true and fair view. However, in judging whether a new policy is more appropriate than the existing policy, an entity will give due weight to the impact on comparability, as explained in paragraph 49.**
- 46 An entity may take account of recently issued FRSS—ie those for which the effective date falls in a later accounting period—in judging whether its present accounting policies are still the most appropriate to its particular circumstances. Paragraph 45 does not require early adoption of a new FRS, because the effective date of a new FRS allows an appropriate period for entities to consider and address any issues surrounding its implementation. However, where it is necessary either to implement a new accounting policy or to change an existing accounting policy, an entity will ensure wherever possible that the new accounting policy is in accordance with recently issued FRSS.
- 47 An entity may take account of Financial Reporting Exposure Drafts (FREDs) in judging which accounting policies are most appropriate to its particular circumstances. However, in accordance with paragraph 14, an entity will not be free to adopt an accounting policy based on a FRED unless that policy is consistent with the requirements of existing accounting standards and UITF Abstracts. Moreover, there may be changes between a FRED and the ensuing FRS. Accordingly, where an entity believes that an accounting policy based on a FRED may be more appropriate than its existing policy, the entity will, in reaching a judgement, consider the factors discussed in paragraph 49.

- 48 Unless other accounting standards, UITF Abstracts or companies legislation require otherwise, a material adjustment applicable to prior periods arising from a change to an accounting policy is accounted for as a prior period adjustment, in accordance with the requirements of FRS 3 'Reporting Financial Performance'.
- 49 Frequent changes to accounting policies will not enhance comparability over the longer term, because they make it more difficult for users to compare an entity's financial statements with those of earlier periods. Consequently, the impact of past and expected future changes is considered when determining whether a potential change is desirable, and accounting policies are not changed unless the benefit to users outweighs the corresponding disadvantages. Nevertheless, consistency is not an end in itself and therefore does not impede the introduction of improved accounting practices that result in an overall benefit to users.

## ESTIMATION TECHNIQUES

- 50 **Where estimation techniques are required to enable the accounting policies adopted to be applied, an entity should select estimation techniques that enable its financial statements to give a true and fair view and are consistent with the requirements of accounting standards, UITF Abstracts and companies legislation.**
- 51 **Where it is necessary to choose between estimation techniques that satisfy the conditions in paragraph 50, an entity should select whichever of those estimation techniques is judged by the entity to be most appropriate to its particular circumstances for the purpose of giving a true and fair view.**

- 52 The purpose of an estimation technique is to arrive at a monetary amount corresponding to a particular measurement basis. Accordingly, it is important for estimation techniques to be reliable and, all other things being equal, an entity will ideally select whichever estimation technique best approximates that monetary amount. However, it may not be possible to identify that estimation technique with certainty, at least at the time that financial statements are prepared, because estimation techniques are used only in circumstances where an amount is unknown. Moreover, materiality and cost and benefit considerations will usually play a part; greater accuracy of estimation often comes at an incremental cost, which may not be justified once improvements in accuracy cease to be material.
- 53 In addition, other factors will sometimes be relevant. In certain circumstances, paragraph 55(b) requires a description of the estimation technique selected to be given, so that users may consider the impact that different judgements might have had on the entity's financial statements and to enable comparisons to be made with the financial statements of other entities. When choosing between estimation techniques in circumstances where disclosures are likely to be required, an entity will also consider the extent to which each technique may be understood by users, and the extent to which each will facilitate comparisons with other entities.
- 54 **A change to an estimation technique should not be accounted for as a prior period adjustment, unless**
- (a) it represents the correction of a fundamental error, or**

- (b) another accounting standard, a UITF Abstract or companies legislation requires the change to be accounted for as a prior period adjustment.

## DISCLOSURES

- 55 The following information should be disclosed in the financial statements:
- (a) a description of each of the accounting policies that is material in the context of the entity's financial statements.
  - (b) a description of those estimation techniques adopted that are significant, as explained in paragraph 57.
  - (c) details of any changes to the accounting policies that were followed in preparing financial statements for the preceding period, including:
    - (i) a brief explanation of why each new accounting policy is thought more appropriate;
    - (ii) where practicable, the effect of a prior period adjustment on the results for the preceding period, in accordance with FRS 3 'Reporting Financial Performance'; and
    - (iii) where practicable, an indication of the effect of a change in accounting policy on the results for the current period.

**Where it is not practicable to make the disclosures described in (ii) or (iii) above, that fact, together with the reasons, should be stated.**

**(d) where the effect of a change to an estimation technique is material, a description of the change and, where practicable, the effect on the results for the current period.**

56 The objective of the disclosures required by paragraph 55(a) is to enable the accounting policies adopted by an entity to be understood by users having a reasonable knowledge of business and economic activities and accounting and a willingness to study with reasonable diligence the information provided. Where an accounting policy is prescribed by, and fully described in, an accounting standard, a UITF Abstract or companies legislation, a succinct description of the policy will satisfy the requirements of paragraph 55(a). Where an accounting policy is not prescribed by an accounting standard, a UITF Abstract or companies legislation, or the entity uses an option permitted therein, a fuller description will be provided.

57 Estimation techniques are used where there is uncertainty over the monetary amount at which an item is to be measured. The amount that is determined will depend both on the estimation technique selected and on any assumptions (such as interest rates and useful lives) used in applying that technique. Although many estimation techniques are used in preparing financial statements, most do not require disclosure because, in most instances, the monetary amounts that might reasonably be ascribed to an item will fall within a relatively narrow range. An estimation technique is significant for the purposes

of paragraph 55(b) only if the range of reasonable monetary amounts is so large that the use of a different amount from within that range could materially affect the view shown by the entity's financial statements. To judge whether disclosures are required in respect of a particular estimation technique, an entity will consider the impact of varying the assumptions underlying that technique. The description of a significant estimation technique will include details of those underlying assumptions to which the monetary amount is particularly sensitive.

### *SORPs*

- 58 Where an entity's financial statements fall within the scope of a SORP, the entity should state the title of the SORP and whether its financial statements have been prepared in accordance with those of the SORP's provisions currently in effect.\* In the event of a departure, the entity should give a brief description of how the financial statements depart from the recommended practice set out in the SORP, which should include:**
- (a) for any treatment that is not in accordance with the SORP, the reasons why the treatment adopted is judged more appropriate to the entity's particular circumstances, and**
  - (b) details of any disclosures recommended by the SORP that have not been provided, and the reasons why they have not been provided.**

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\* The provisions of a SORP will cease to have effect, for example, to the extent that they conflict with a more recent accounting standard or UIFT Abstract.

- 59 SORPs recommend particular accounting treatments with the aim of narrowing areas of difference and variety between comparable entities. Compliance with a SORP that has been generally accepted by an industry or sector leads to enhanced comparability between the financial statements of entities in that industry or sector. Comparability is further enhanced if users are made aware of the extent to which an entity complies with a SORP, and the reasons for any departures. The effect of a departure from a SORP need not be quantified, except in those rare cases where such quantification is necessary for the entity's financial statements to give a true and fair view.
- 60 Entities whose financial statements do not fall within the scope of a SORP may nevertheless choose to comply with the SORP's recommendations when preparing financial statements. Where this is the case, entities are encouraged to disclose that fact.

*Going concern*

- 61 **The following information should be disclosed in the financial statements in relation to the going concern assessment required by paragraph 23:**
- (a) **any material uncertainties, of which the directors are aware in making their assessment, related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.**
  - (b) **where the foreseeable future considered by the directors has been limited to a period of less than one year from the date of approval of the financial statements, that fact.**



- (c) when the financial statements are not prepared on a going concern basis, that fact, together with the basis on which the financial statements are prepared and the reason why the entity is not regarded as a going concern.

*True and fair view override*

- 62 For any material departure from the requirements of an accounting standard, a UITF Abstract or companies legislation, particulars of the departure, the reasons for it and its effect should be disclosed. The information disclosed should include:
- (a) a clear and unambiguous statement that there has been a departure from the requirements of an accounting standard, a UITF Abstract or companies legislation, as the case may be, and that the departure is necessary to give a true and fair view.
  - (b) a statement of the treatment that the accounting standard, UITF Abstract or companies legislation would normally require in the circumstances and a description of the treatment actually adopted.
  - (c) a statement of why the treatment prescribed would not give a true and fair view.
  - (d) a description of how the position shown in the financial statements is different as a result of the departure, normally with quantification, except where

- (i) **quantification is already evident in the financial statements themselves;<sup>\*</sup> or**
  - (ii) **the effect cannot reasonably be quantified, in which case the directors should explain the circumstances.**
- 63 Where a departure continues in subsequent financial statements, the disclosures should be made in all such subsequent statements, and should include corresponding amounts for the previous year. Where a departure affects only the corresponding amounts, the disclosures should be given for those corresponding amounts.**
- 64 Where companies legislation requires an entity to make a statement of whether its financial statements have been prepared in accordance with applicable accounting standards,<sup>†</sup> that statement should either include or cross-reference any disclosures required by paragraph 62.**
- 65 Where companies legislation requires disclosure of particulars of a departure from a specific statutory requirement, the reasons for it and its effect, disclosures equivalent to those set out in paragraph 62 should be provided.<sup>◇</sup>**

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*\* An example might be a matter of presentation rather than measurement.*

*† This disclosure is required by companies legislation as follows: in Great Britain, the Companies Act 1985, Schedule 4, paragraph 36A; and in Northern Ireland, the Companies (Northern Ireland) Order 1986, Schedule 4, paragraph 36A. There is no equivalent requirement in the Republic of Ireland.*

*◇ In Great Britain, such disclosures in connection with a departure are required by the Companies Act 1985, sections 226(5) and 227(6), Schedule 4 paragraph 15, Schedule 4A paragraph 3(2), Schedule 8 paragraph 15, Schedule 9 paragraph 22 and Schedule 9A paragraph 19. The equivalent requirements in Northern Ireland and in the Republic of Ireland are set out in Appendix II.*

**DATE FROM WHICH EFFECTIVE**

- 66 Subject to paragraph 67, the accounting practices set out in the FRS should be regarded as standard in respect of accounting periods ending on or after 22 June 2001. Earlier adoption is encouraged.**
- 67 Paragraphs 58–60 and the last sentence of paragraph 40 need not be applied in respect of accounting periods beginning on or before 23 December 2001, but earlier application is encouraged.**

**WITHDRAWAL OF SSAP 2 AND UITF  
ABSTRACTS 7 AND 14 AND AMENDMENT  
OF OTHER ACCOUNTING STANDARDS  
AND UITF ABSTRACTS**

- 68 The FRS supersedes SSAP 2 ‘Disclosure of accounting policies’, UITF Abstract 7 ‘True and fair view override disclosures’ and UITF Abstract 14 ‘Disclosure of changes in accounting policy’.**
- 69 The FRS makes the following changes to other accounting standards and UITF Abstracts:**
- (a) the references to “SSAP 2” in**
- (i) paragraph 19 of SSAP 13 ‘Accounting for research and development’,**
- (ii) paragraph 74 of FRS 13 ‘Derivatives and other Financial Instruments: Disclosures’,**

**(iii) paragraph 5 and under the heading ‘References’ in UITF Abstract 6 ‘Accounting for post-retirement benefits other than pensions’, and**

**(iv) paragraph 3 and under the heading ‘References’ in UITF Abstract 12 ‘Lessee accounting for reverse premiums and similar incentives’**

**are replaced by references to “FRS 18 ‘Accounting Policies’”.**

**(b) in paragraph 17 of SSAP 19 ‘Accounting for investment properties’, the final sentence is replaced by**

“Paragraphs 62–65 of FRS 18 ‘Accounting Policies’ specify disclosures that should be made in connection with this statutory requirement.”

**(c) in paragraph 29 of FRS 3 ‘Reporting Financial Performance’, the final sentence is replaced by**

“Where practicable, the effect of a prior period adjustment on the results for the preceding period should be disclosed. Where it is not practicable to make this disclosure, that fact, together with the reasons, should be stated.”

**(d) in paragraph 51 of FRS 3, the word “fundamental” in the first sentence is deleted.**

**(e) in paragraph 62 of FRS 3, the first four sentences are replaced by**

“Where possible, the objective of comparability requires, inter alia, that there is consistency of accounting treatment within each accounting period and from one period to the next. FRS 18 ‘Accounting Policies’ requires an entity to adopt those accounting policies that are most appropriate to its particular circumstances. Accordingly, a change in accounting policy will be made only where a new policy is judged more appropriate. Where transactions or events that are clearly different in substance from those previously occurring necessitate the introduction of an accounting policy in circumstances where no policy previously existed, that is not a change in accounting policy.”

**(f) in paragraph 60 of FRS 10 ‘Goodwill and Intangible Assets’, the last three sentences are replaced by**

“Paragraphs 62–65 of FRS 18 ‘Accounting Policies’ specify disclosures that should be made in order to provide the reader of the financial statements with a clear and unambiguous account of the reasons for the departure from the statutory requirement. The specific factors will be unique to the circumstances of each case. The requirements of FRS 18 encompass the disclosures necessary when it is not possible to quantify the effect of the departure, as will be the case when goodwill is not amortised.”

- (g) in paragraph 67 of FRS 10 the reference to “UITF Abstract 14 ‘Disclosure of changes in accounting policy’” is replaced by a reference to “FRS 18 ‘Accounting Policies’”.**
- (h) in paragraph 73 of FRS 13, the first sentence is replaced by**

“FRS 18 ‘Accounting Policies’ requires a description to be given of each of the accounting policies that is material in the context of an entity’s financial statements.”

## **ADOPTION OF FRS 18 BY THE BOARD**

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*Financial Reporting Standard 18 ‘Accounting Policies’ was approved for issue by the ten members of the Accounting Standards Board.*

Sir David Tweedie      (Chairman)  
Allan Cook CBE      (Technical Director)  
David Allvey  
Ian Brindle  
Dr John Buchanan  
John Coombe  
Huw Jones  
Isobel Sharp  
Professor Geoffrey Whittington  
Ken Wild

## APPENDIX I

### EXAMPLES OF CHANGES TO ACCOUNTING POLICIES AND TO ESTIMATION TECHNIQUES

*This appendix illustrates the application of the FRS to assist in clarifying its meaning. It does not form part of the FRS.*

#### **Example 1:** *Capitalised finance costs*

An entity has previously charged to the profit and loss account interest incurred in connection with the construction of tangible fixed assets. It now proposes to capitalise such interest, as permitted by FRS 15 'Tangible Fixed Assets', since it believes this better reflects the cost of constructing those assets.

<i>Does this involve a change to:</i>	
<i>Recognition?</i>	✓
<i>Presentation?</i>	✓
<i>Measurement basis?</i>	✗

**Explanation**—The transaction whose effects are being reflected is the incurring of directly attributable finance costs. That transaction is still being measured in the same way, but there is a change to recognition, in that it is now being recognised as (part of) an asset rather than as an expense.\* There is also, consequently, a change to the presentation of the transaction in the balance sheet and the profit and loss account.

**Conclusion**—This is a change of accounting policy.

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\* Paragraph 9 of the FRS notes that where accounting standards allow a choice over what is to be recognised, that choice is a matter of accounting policy.



**Example 2:*****Indirect overheads recorded in the value of stock***

A manufacturing entity has three indirect cost centres (A, B and C). It has previously assessed that the indirect costs attributable to production are 30 per cent of A and 40 per cent of B. Having reassessed the nature of those cost centres' activities, it now assesses that the indirect costs attributable to production are 25 per cent of A, 40 per cent of B and 10 per cent of C.

<b><i>Does this involve a change to:</i></b>	
<i>Recognition?</i>	<b>✗</b>
<i>Presentation?</i>	<b>✗</b>
<i>Measurement basis?</i>	<b>✗</b>

**Explanation**—This example has similarities with Example 1; cost centre C may be contrasted with interest in that example. The key difference is that, in Example 1, FRS 15 allows the entity a choice of how to treat directly attributable interest—as an asset or as an expense. There is no such choice here; directly attributable costs, once estimated, must be treated as part of an asset. Accordingly there is no change to recognition. In addition, both stocks and overheads continue to be presented in the same way and measured on the same basis (stocks are measured at the amount of directly attributable historical costs).

**Conclusion**—This is a change of estimation technique.

**Example 3:**  
*Classification of overheads*

An entity has previously shown certain overheads within cost of sales. It now proposes to show those overheads within administrative expenses.

<i>Does this involve a change to:</i>	
<i>Recognition?</i>	<b>X</b>
<i>Presentation?</i>	<b>✓</b>
<i>Measurement basis?</i>	<b>X</b>

**Explanation**—Although there is no change to the recognition and measurement of costs, they are being presented differently.

**Conclusion**—This is a change of accounting policy.

**Example 4a:**  
*Depreciation of vehicles*

An entity has previously depreciated vehicles using the reducing balance method at 40 per cent per year. It now proposes to depreciate vehicles using the straight-line method over five years, since it believes this better reflects the pattern of consumption of economic benefits.

<i>Does this involve a change to:</i>	
<i>Recognition?</i>	<b>X</b>
<i>Presentation?</i>	<b>X</b>
<i>Measurement basis?</i>	<b>X</b>

**Explanation**—Vehicles are being recognised and presented in the same way as before, and using the same, historical cost measurement basis. The only change is to the estimation technique used to measure the unexpired portion of each vehicle’s economic benefits.

**Conclusion**—This is not a change of accounting policy.\*

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\* Paragraph 82 of FRS 15 also states that a change from one method of providing depreciation to another does not constitute a change of accounting policy.

**Example 4b:**  
*Depreciation of vehicles*

As in Example 4a, an entity has previously depreciated vehicles using the reducing balance method at 40 per cent per year and now proposes to depreciate vehicles using the straight-line method over five years. In addition, it has previously recorded the depreciation charge within cost of sales, but now proposes to include it within administrative expenses.

<i>Does this involve a change to:</i>	
<i>Recognition?</i>	<b>X</b>
<i>Presentation?</i>	<b>✓</b>
<i>Measurement basis?</i>	<b>X</b>

**Explanation**—This accounting change involves both a change to presentation, as in Example 3 above, and a change of estimation technique, as in Example 4a above. For the reasons set out in those examples, the former is a change of accounting policy but the latter is not.

**Conclusion**—The two changes are accounted for separately. No change is made to the amount of depreciation charged in earlier periods, but the profit and loss account for the preceding period is restated to move the depreciation charge from cost of sales to administrative expenses.

**Example 5:**  
*Accounting for fungible stocks*

An entity has fungible stocks and its accounting policy has previously been to consider those stocks in aggregate, measuring them at weighted average historical cost. However, it determines that the normal accounting policy in its industry is to measure such stocks at historical cost on a FIFO basis. It concludes, for reasons of comparability, that it should adopt the normal industry policy.

<i><b>Does this involve a change to:</b></i>	
<i>Recognition?</i>	<b>✗</b>
<i>Presentation?</i>	<b>✗</b>
<i>Measurement basis?</i>	<b>✓</b>

**Explanation**—There is explicitly a change of measurement basis.\*

**Conclusion**—This is a change of accounting policy, and it should be disclosed. However, a prior period adjustment will be required only if the difference between weighted average and FIFO is material.

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\* As explained in paragraph 10 of the FRS, an entity with fungible assets will make clear, when disclosing its accounting policy, whether it is to consider those assets individually or, if in aggregate, which measurement basis is reflected (FIFO, weighted average etc.). For many entities, however, the difference between measurement bases in value terms may not be material.

**Example 6a:**  
***Discounting***

An entity has previously reported deferred tax on an undiscounted basis. However, the norm in its industry is to report deferred tax on a discounted basis. It concludes, for reasons of comparability, that it should adopt the normal industry approach.

<b><i>Does this involve a change to:</i></b>	
<i>Recognition?</i>	<b>X</b>
<i>Presentation?</i>	<b>X</b>
<i>Measurement basis?</i>	<b>✓</b>

**Explanation**—FRS 19 allows entities to report deferred tax on either a discounted or an undiscounted basis. These are two different measurement bases, and it is a matter of accounting policy which an entity chooses to adopt.

**Conclusion**—This is a change of accounting policy.

**Example 6b:**  
***Discounting***

An entity has previously measured a particular provision on an undiscounted basis, in accordance with FRS 12 'Provisions, Contingent Liabilities and Contingent Assets', as the effect of discounting was not material. However, this year it has revised upwards its estimates of future cash flows associated with the provision and, as a result, the effect of discounting is now material. FRS 12 therefore requires it to report the provision at the discounted amount.

<b><i>Does this involve a change to:</i></b>	
<i>Recognition?</i>	<b>✗</b>
<i>Presentation?</i>	<b>✗</b>
<i>Measurement basis?</i>	<b>✗</b>

**Explanation**—FRS 12 requires entities to report provisions at the best estimate of the expenditure required to settle the present obligation at the balance sheet date. Where that estimate is based on future cash flows, it is permissible to use undiscounted amounts only where the effect of the time value of money is not material. In such circumstances, the use of undiscounted future cash flows is, in effect, an estimation technique for arriving at the present value.

**Conclusion**—This is not a change of accounting policy.

**Example 7:*****Translating the financial statements of a foreign subsidiary***

A group has previously translated the profit and loss account of its foreign subsidiary using the closing rate. However, it now proposes to use the average rate for the accounting period, on the basis that this reflects more fairly the group's profits and losses as they arise throughout the accounting period.

<b><i>Does this involve a change to:</i></b>	
<i>Recognition?</i>	<b>X</b>
<i>Presentation?</i>	<b>X</b>
<i>Measurement basis?</i>	<b>✓</b>

**Explanation**—SSAP 20 'Foreign currency translation' allows a group translating the profit and loss account of a foreign subsidiary under the closing rate/net investment method to use either the closing rate or the average rate for the accounting period. These are two different measurement bases for the profit and loss account, and it is a matter of accounting policy which an entity chooses to adopt.

**Conclusion**—This is a change of accounting policy.



## APPENDIX II

### NOTE ON LEGAL REQUIREMENTS

#### *Great Britain*

- 1 The statutory requirements relating to accounting policies are set out in the Companies Act 1985. The main requirements that are directly relevant are set out in Schedules 4 and 4A and are summarised below.
- 2 Schedules 4 and 4A to the Act do not apply to banking and insurance companies and groups. Corresponding requirements are set out in Schedule 9 for banking companies and groups and in Schedule 9A for insurance companies and groups. Schedule 4 to the Act does not apply to small companies to the extent that they choose instead to comply with the reduced requirements set out in Schedule 8.

#### *Accounting principles*

- 3 Paragraph 9 of Schedule 4 requires the amounts to be included in a company's accounts to be determined in accordance with the following principles set out in paragraphs 10–14 of Schedule 4, unless there are special reasons for departing from any of those principles:
  - (a) the company shall be presumed to be carrying on business as a going concern;
  - (b) accounting policies shall be applied consistently within the same accounts and from one financial year to the next;

- (c) the amount of any item shall be determined on a prudent basis, and in particular—
    - (i) only profits realised at the balance sheet date shall be included in the profit and loss account; and
    - (ii) all liabilities and losses which have arisen or are likely to arise in respect of the financial year to which the accounts relate or a previous financial year shall be taken into account, including those which only become apparent between the balance sheet date and the date on which it is signed on behalf of the board of directors;
  - (d) all income and charges relating to the financial year to which the accounts relate shall be taken into account, without regard to the date of receipt or payment; and
  - (e) in determining the aggregate amount of any item the amount of each individual asset or liability that falls to be taken into account shall be determined separately.
- 4 Paragraph 15 of Schedule 4 permits the directors of a company to depart from any of the principles stated above in preparing the company's accounts in respect of any financial year if it appears to them that there are special reasons for such a departure. Particulars of the departure, the reasons for it and its effect are required to be given in a note to the accounts.

- 5 Although “prudence” is not defined in the Act, the Act describes the requirement that the amount of any item shall be determined on a prudent basis in a way that differs from the FRS. Nevertheless, the Board believes that the requirements of the FRS are not inconsistent with those of the Act.\*

*Disclosure of accounting policies*

- 6 Paragraph 36 of Schedule 4 requires disclosure of the accounting policies adopted by a company (including the policies regarding the depreciation and diminution in value of assets).†

*Measurement bases*

- 7 Except to the extent that a company chooses to adopt the alternative accounting rules, the amounts to be included in a company’s accounts are to be determined in accordance with the historical cost accounting rules set out in paragraphs 17–28 of Schedule 4. The alternative accounting rules are set out in paragraphs 29–34 of Schedule 4.

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\* This matter is discussed in greater detail in paragraphs 3–8 of Appendix V to FRS 12 ‘Provisions, Contingent Liabilities and Contingent Assets’.

† According to legal advice received by the Financial Reporting Review Panel, a statement that accounts have been prepared in accordance with applicable accounting standards, as required by paragraph 36A, does not satisfy the requirement in paragraph 36. To satisfy that requirement, there must be a brief statement of each relevant accounting policy, either in the accounts themselves or in the notes to the accounts. However, paragraph 36 does not require disclosure of accounting policies that are immaterial in the context of the accounts in question.

- 8 The following paragraphs of Schedule 4 require disclosures in respect of measurement bases:
- (a) where stocks or other fungible assets are measured using ‘first in, first out’ (FIFO), ‘last in, first out’ (LIFO),\* weighted average price or a similar method, paragraph 27(3) requires the difference between the amount measured using that method and on the basis of replacement cost at the balance sheet date, or of most recent actual cost, to be disclosed if material.
  - (b) where the alternative accounting rules set out in paragraph 31 are adopted as the measurement bases for certain assets, paragraph 33(2) requires disclosure of each item affected and the basis of valuation, and paragraph 33(3) requires disclosure for each item affected (except stocks) either of the amount that would have been determined under the historical cost accounting rules, or of the difference between the amount measured under the historical cost accounting rules and under the alternative accounting rule adopted.
  - (c) paragraph 45(2) requires disclosure of the aggregate market value of listed investments where this differs from the amount included in a company’s accounts, and of both the market value and the stock exchange value of any investments of which the former value is, for the purposes of a company’s accounts, taken as being higher than the latter.

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\* SSAP 9 ‘Stocks and long-term contracts’ notes that “the use of the LIFO method can result in the reporting of current assets at amounts that bear little relationship to recent costs. This may result in not only a significant misstatement of balance sheet amounts but also a potential distortion of current and future results. This places a special responsibility on the directors to be assured that the circumstances of the company require the adoption of such a valuation method in order for the accounts to give a true and fair view.”

- (d) paragraph 58(1) requires disclosure of the basis on which any amounts originally denominated in foreign currencies have been translated into sterling for inclusion in the balance sheet or profit and loss account.

### *Comparability*

- 9 Paragraph 4(2) of Schedule 4 requires the corresponding amount for any item in a company's balance sheet or profit and loss account to be adjusted if it is not comparable with the amount for the current financial year. Particulars of the adjustment and the reasons for it are to be disclosed. Paragraph 58(2) of Schedule 4 extends this requirement to corresponding amounts stated in notes to the accounts, with the exception of the items listed in paragraph 58(3) of Schedule 4.

### *Group accounts*

- 10 Where assets and liabilities to be included in group accounts have been valued or otherwise determined according to accounting rules differing from those used for the group accounts, paragraph 3 of Schedule 4A requires the values or amounts to be adjusted so as to accord with the rules used for the group accounts, unless it appears to the directors of the parent company that there are special reasons for departing from this rule. Particulars of any such departure, the reasons for it and its effect shall be given in a note to the accounts.

- 11 Paragraph 4 of Schedule 4A requires any differences of accounting rules as between a parent company's individual accounts for a financial year and its group accounts to be disclosed in a note to the group accounts and the reasons for the difference to be given.

*The true and fair view override*

- 12 In special circumstances, compliance with a provision of the Act on the matters to be included in a company's accounts (or notes thereto) may be inconsistent with the requirement to give a true and fair view of the state of affairs and profit or loss. Sections 226(5) and 227(6) of the Act provide, for individual company accounts and for group accounts, that in such circumstances the directors shall depart from that provision to the extent necessary to give a true and fair view.\* Where this true and fair view override is used, the Act requires particulars of the departure, the reasons for it and its effect to be given in a note to the accounts.

*Realisation*

- 13 Part VIII of the Act sets limits on a company's ability to make distributions to its members. Different rules apply to public companies, private companies, investment companies and insurance companies, but

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\* However, if a true and fair view can be achieved by the provision of additional information, there is no inconsistency. No departure is allowed in such circumstances.

those rules are in part concerned with whether gains and losses have been realised. Realised profits and realised losses are defined in section 262(3) of the Act:

“References in this Part to “realised profits” and “realised losses”, in relation to a company’s accounts, are to such profits or losses of the company as fall to be treated as realised in accordance with principles generally accepted, at the time when the accounts are prepared, with respect to the determination for accounting purposes of realised profits or losses.

This is without prejudice to—

- (a) the construction of any other expression (where appropriate) by reference to accepted accounting principles or practice, or
- (b) any specific provision for the treatment of profits or losses of any description as realised.”

- 14 The concept of realisation is discussed further in paragraphs 15–20 of Appendix IV.

### ***Northern Ireland***

- 15 The statutory requirements in Northern Ireland are set out in the Companies (Northern Ireland) Order 1986. Those requirements are identical to the legislation for Great Britain cited above.

***Republic of Ireland***

- 16 The statutory requirements in the Republic of Ireland that correspond to those cited above for Great Britain are shown in the following table.

<i>Great Britain</i>	<i>Republic of Ireland</i>
section 226(5) of the Companies Act 1985	section 3(1) of the Companies (Amendment) Act 1986
section 227(6) of the Companies Act 1985	Regulation 14(3) and (4) of the European Communities (Companies: Group Accounts) Regulations 1992
section 262(3) of the Companies Act 1985	paragraph 72 of the Schedule to the Companies (Amendment) Act 1986
Part VIII of the Companies Act 1985	Part IV of the Companies (Amendment) Act 1983
Schedule 4 to the Companies Act 1985:	The Companies (Amendment) Act 1986:
paragraph 4(2)	section 4(8)
paragraph 9	section 5
paragraph 10	section 5(a)
paragraph 11	section 5(b)
paragraph 12	section 5(c)



paragraph 13	section 5(d)
paragraph 14	section 5(e)
paragraph 15	section 6
Schedule 4 to the Companies Act 1985:	The Schedule to the Companies (Amendment) Act 1986:
paragraphs 17–28	paragraphs 5–16 <sup>*</sup>
paragraph 27(3)	paragraph 15(3)
paragraphs 29–34	paragraphs 17–22 <sup>†</sup>
paragraph 33(2)	paragraph 21(2)
paragraph 33(3)	paragraph 21(3)
paragraph 36	paragraph 24
paragraph 36A	no equivalent
paragraph 45(2)	paragraph 31(2)
paragraph 58(1)	paragraph 44(1)
paragraph 58(2)	paragraph 44(2)
paragraph 58(3)(a)–(c)	no equivalent
paragraph 58(3)(d)	paragraph 44(3)

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<sup>\*</sup> Note: there is no requirement corresponding to paragraph 27(2)(b) of Schedule 4.

<sup>†</sup> Note: there is no requirement corresponding to paragraph 34(3A) of Schedule 4.

Schedule 4A to the Companies Act 1985:	European Communities (Companies: Group Accounts) Regulations 1992:
paragraph 3	Regulation 30
paragraph 4	Regulation 29
Schedule 8 to the Companies Act 1985	no equivalent
Schedule 9 to the Companies Act 1985	European Communities (Credit Institutions: Accounts) Regulations 1992
Schedule 9A to the Companies Act 1985	European Communities (Insurance Undertakings: Accounts) Regulations 1996

## APPENDIX III

### COMPLIANCE WITH INTERNATIONAL ACCOUNTING STANDARDS

- 1 The International Accounting Standards Committee deals with accounting policies in its standards IAS 1 (revised 1997) ‘Presentation of Financial Statements’ and IAS 8 (revised 1993) ‘Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies’. The general requirements for accounting policies in the FRS are consistent with those standards, except as discussed below.
- 2 IAS 8 (revised 1993) defines accounting policies as the specific principles, bases, conventions, rules and practices adopted by an enterprise in preparing and presenting financial statements. The definition in the FRS also refers to principles, bases, conventions, rules and practices, but it is more specific about the role that accounting policies play in the preparation and presentation of financial statements. Specifically, accounting policies are applied by an entity in order to reflect the effects of transactions and other events through recognising, selecting measurement bases for, and presenting assets, liabilities, gains, losses and changes to shareholders’ funds.
- 3 The FRS defines estimation techniques and distinguishes them from accounting policies. IAS 8 (revised 1993) distinguishes between a change of accounting policy and a change of accounting estimate, but does not include an equivalent definition.

- 4 IAS 1 (revised 1997) requires management to develop accounting policies that provide information that is relevant and reliable, and that provide the most useful information to users, but only in the absence both of a specific IAS and of an interpretation of the Standing Interpretations Committee. Accordingly, where specific IASs or interpretations of the Standing Interpretations Committee allow different treatments, an entity is permitted a free choice; it is not required in such circumstances to choose whichever policy will provide the most useful information to users. By contrast, the FRS requires that, where more than one treatment is allowed, an entity should use the criteria of relevance, reliability, comparability and understandability to select the policy that is the most appropriate of those allowed.
  
- 5 IAS 1 (revised 1997) requires management to make an assessment of an enterprise's ability to continue as a going concern, taking into account all available information for the foreseeable future, which should be at least, but is not limited to, twelve months from the balance sheet date. The FRS includes a similar requirement but, like the UK Auditing Standard SAS 130 'The going concern basis in financial statements', it does not specify a minimum length for the foreseeable future. Instead, it requires disclosure where the directors have considered a period of less than twelve months from the date of approval of the financial statements.

- 6 IAS 1 (revised 1997) requires financial statements to be prepared on a going concern basis unless management either intends to liquidate the enterprise or to cease trading, or has no realistic alternative but to do so. The FRS includes a requirement that is similar except that management intent is not sufficient to justify a departure from the going concern basis. Accordingly, the FRS requires an entity's financial statements to be prepared on a going concern basis unless the entity is being liquidated or has ceased trading, or the directors have no realistic alternative but to liquidate the entity or to cease trading.

## APPENDIX IV

### THE DEVELOPMENT OF THE FRS

#### *History*

- 1 The FRS sets out the principles to be followed in selecting accounting policies and the disclosures needed to help users to understand the accounting policies adopted and how they have been implemented. It supersedes SSAP 2 ‘Disclosure of accounting policies’, which was issued in November 1971.
- 2 The objective of SSAP 2 was to ensure disclosure in an entity’s financial statements of clear explanations of the accounting policies followed insofar as they were significant for the purpose of giving a true and fair view. At the time it was issued, no statement of principles existed in the UK and the Republic of Ireland to provide a framework within which ‘accounting policies’ might be defined. Accordingly, SSAP 2 introduced and defined ‘fundamental accounting concepts’, singling out four—going concern, accruals, consistency and prudence—which have since been reflected in the EC Accounting Directives and in companies legislation in the UK and the Republic of Ireland.\*
- 3 SSAP 2 made clear that this approach was expedient rather than theoretical. The fundamental accounting concepts were to be regarded as working assumptions having general acceptance at the time of issue of the standard—practical rules rather than theoretical ideals.

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\* See paragraphs 3 and 4 of Appendix II ‘Note on legal requirements’ (and paragraph 16 for the Republic of Ireland).

It was envisaged that, as accounting thought and practice developed, the concepts would be capable of variation and evolution.

- 4 In December 1999, the Board issued its Statement of Principles for Financial Reporting, which reflected, among other things, how accounting developments in the 28 years since SSAP 2 was issued had affected the fundamental accounting concepts identified in that standard. Although the Statement of Principles discussed each of the concepts individually, they were no longer referred to as 'fundamental accounting concepts' and their respective roles had changed, as explained further below.
- 5 A number of respondents to the Revised Exposure Draft of the Statement of Principles commented that SSAP 2 should be amended in the light of that document. The Board agreed and in December 1999 it published FRED 21 'Accounting Policies', which set out proposals to update the concepts underpinning SSAP 2. In other respects, the Board regarded SSAP 2 as broadly satisfactory, retaining many of its requirements in FRED 21, but it took the opportunity to clarify and to expand on certain matters. Accordingly, the FRED:
  - sought to make the distinction between a change of accounting policy and a change of estimate more robust, by including a more specific definition of accounting policies and a new definition of estimation techniques
  - set out clearly a requirement, implied but not explicit in SSAP 2, that an entity should adopt those accounting policies that are most appropriate to its particular circumstances for the purpose of giving a true and fair view

- set out the objectives and constraints to be considered when selecting and changing accounting policies
  - set out circumstances in which an entity should also disclose details of the estimation techniques used in implementing its accounting policies.
- 6 The Board has considered the comments of respondents to FRED 21 in developing the FRS. The most significant comments, and the resulting changes made to the proposals in FRED 21, are discussed in the following sections.

### *The fundamental accounting concepts in SSAP 2*

- 7 As SSAP 2 envisaged, the meanings attaching to the fundamental accounting concepts, and their individual importance relative to one another, have developed and evolved over time. Accordingly, they are treated somewhat differently in the FRS from the way in which they were treated in SSAP 2.

### *Going concern and accruals*

- 8 Two of the concepts—going concern and accruals—have a particularly prominent role in the FRS. That is because they are part of the bedrock of accounting, and hence critical to the selection of accounting policies. The going concern assumption determines the perspective from which the objectives and constraints set out in the FRS should be viewed, particularly with regard to measurement. The accruals concept lies at the heart of the definitions of assets, liabilities, gains, losses and changes to shareholders' funds, and both notions play an important role in the recognition of those items.



- 9 In discussing the accruals concept, SSAP 2 explained that revenues and costs should be matched with one another so far as their relationship can be established or justifiably assumed, and dealt with in the profit and loss account of the period to which they relate. The FRS takes a slightly different approach to the accruals concept. Rather than focusing on when a relationship can be established or justifiably assumed, it emphasises instead that the non-cash effects of transactions and other events should be reflected, as far as is possible, in the financial statements for the accounting period in which they occur, and not, for example, in the period in which any cash involved is received or paid.\* Together with the definitions of assets and liabilities, set out in FRS 5 ‘Reporting the Substance of Transactions’, this provides a discipline within which the matching process can operate, while still resulting in the simultaneous recognition of revenues and costs that result from the same transactions or events.
- 10 SSAP 2 did not require financial statements to be prepared in accordance with the going concern and accruals concepts; rather, where this was not the case, it required the facts to be disclosed and explained. This approach was also taken in FRED 21, but several respondents suggested that the role of these concepts should be strengthened. Respondents also suggested that disclosure should be required of any material uncertainties that might cast doubt on an entity’s ability to continue as a going concern, as is the case under the International Accounting Standard IAS 1 (revised 1997) ‘Presentation of Financial Statements’.

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\* This approach is consistent with that taken in the Statement of Principles.

- 11 The Board has accepted these proposals. Accordingly the FRS requires financial statements to be prepared on a going concern basis\* and on the accruals basis. The FRS also requires directors to assess whether there are significant doubts about the entity's ability to continue as a going concern and to disclose any material uncertainties, of which they are aware, related to events or conditions that may raise such doubts.†

*Consistency and prudence*

- 12 The other two concepts from SSAP 2—consistency and prudence—are rather different in that they are desirable qualities of financial information rather than part of the bedrock of accounting. The FRS therefore discusses them in the context of the objectives against which an entity should judge the appropriateness of accounting policies to its particular circumstances.
- 13 Like the Statement of Principles, the FRS regards comparability as a more fundamental objective than consistency. Information in financial statements should be prepared and presented in a way that enables users to discern and evaluate similarities in, and differences between, the nature and effects of transactions and other events taking place over time and across different reporting entities. Although comparability is usually achieved through consistency, the latter is not an end in itself and there will be circumstances in which it needs to be sacrificed. In particular, whilst consistency is important, it should not be allowed to prevent improvements in accounting. Where the introduction of a new accounting policy would result in an overall benefit to

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\* *Except where an entity is being liquidated or has ceased trading, or the directors have no realistic alternative but to liquidate the entity or to cease trading.*

† *Differences between the requirements of the FRS and of IAS 1 (revised 1997) are discussed in Appendix III.*

users, an entity should not use consistency to justify retaining an existing policy that is no longer the most appropriate to its particular circumstances.

- 14 The FRS also reflects how the prudence concept has evolved from the way in which it was described in SSAP 2. Since SSAP 2 was issued, the smoothing of reported profits has become as great a concern as their overstatement and, as a result, the deliberate understatement of assets and gains and the deliberate understatement of liabilities are no longer seen as a virtue. Accordingly, like the Statement of Principles, the FRS treats prudence as one aspect of the overall objective of reliability. In conditions of uncertainty, prudence requires more confirmatory evidence about the existence of an asset or gain than about the existence of a liability or loss, and a greater reliability of measurement for assets and gains than for liabilities and losses.

#### *Realisation*

- 15 One aspect of prudence as described in SSAP 2 was that revenue and profits should be included in the profit and loss account only when realised in the form either of cash or of other assets the ultimate cash realisation of which could be assessed with reasonable certainty. However, the FRS does not refer to the notion of realisation in discussing prudence.
- 16 The realisation notion was originally concerned with the conversion into cash of non-cash resources and rights, and was intended to ensure that sufficient cash was available to distribute profits without an entity becoming insolvent. By the time SSAP 2 was issued, the notion had evolved so that it was also concerned with claims to cash, and was used to ensure that only gains that were reasonably certain, and unlikely to reverse, were included in the profit and loss account.

- 17 By the time that FRED 21 was being developed, however, the linking of prudence to realisation in SSAP 2 had itself become out of date. Markets have developed so that it is often possible to be reasonably certain that a gain exists, and to measure it with sufficient reliability, even if no disposal has occurred. One approach to this problem might have been to try to update the notion of realisation. However, the Board believes that it is preferable to focus on the underlying objective. In the Board's view, this is that a gain should be recognised only if there is reasonable certainty that it exists and if it can be measured reliably. Accordingly, the FRED and the FRS both discuss the concept of prudence in these terms, rather than in terms of realisation.
- 18 This approach provoked much comment from respondents to the FRED, with some supportive but many expressing concern. Two themes emerged strongly from the responses:
- although the Board does not believe that it is useful to link prudence and realisation, requirements based on the notion of realisation are nevertheless part of companies legislation. Respondents were concerned that the Board appeared, in effect, to be encouraging entities to ignore or flout those requirements.
  - rather than fixing the interpretation of the notion of realisation, companies legislation requires it to be determined in accordance with principles generally accepted at the time when financial statements are prepared. The description of realisation in SSAP 2 provided a strong underpinning to those principles, and respondents were concerned that its omission from the FRED would lead to that underpinning being removed.

- 19 As regards the first concern, it was never the Board's intention to encourage entities to ignore or flout requirements of companies legislation. Certain paragraphs from the FRED have been redrafted to reduce any risk of ambiguity in that regard. In particular, paragraph 14 of the FRS makes clear that entities should adopt accounting policies that are consistent with the requirements of other accounting standards and of companies legislation, which will include any requirements relating to realisation. Paragraph 29 and its footnote have also been redrafted to avoid wrongly giving the impression that the Board is encouraging entities to depart from such requirements.
- 20 The words from SSAP 2 describing the notion of realisation have been included in paragraph 28 of the FRS in order to address the second concern. Although the FRS does not maintain the link between prudence and realisation from SSAP 2, the Board had not intended to create uncertainty in respect of existing realisation requirements, and the inclusion of these words is intended to preserve the status quo.

### ***Definitions***

#### *Accounting bases*

- 21 SSAP 2 defined both accounting bases and accounting policies. It explained that accounting bases are the methods developed for applying fundamental accounting concepts to financial transactions and items, while accounting policies are the specific accounting bases adopted by an entity. In developing the FRS, the Board considered whether the concept of accounting bases was useful in defining accounting policies.

- 22 The Board noted that definitions of accounting policies adopted by other standard-setters do not refer to accounting bases in this way. In addition, it noted that there are no other UK accounting standards in which the phrase ‘accounting bases’ is used, and that a distinction between accounting bases and accounting policies does not appear to have any practical consequences for recognition, measurement or disclosure in financial statements. Finally, it noted that references in SSAP 2 to accounting bases had led in some instances to confusion, for example about whether a choice of depreciation method was an accounting basis.
- 23 For these reasons, the Board concluded that it is not necessary, and might be confusing, to continue to define accounting policies as the specific accounting bases adopted by an entity. Instead, the FRS makes clear by its context whether the phrase ‘accounting policies’ refers to such policies in general or to the specific policies adopted by an entity.

*Accounting policies and estimation techniques*

- 24 Having recognised that it is not always easy to distinguish between a change of accounting policy and a change of estimate, the Board also looked again at the definition of an accounting policy. SSAP 2 referred to “the methods developed for applying fundamental accounting concepts to financial transactions and items”, but it is clear that some methods adopted by an entity are merely estimates rather than accounting policies.

- 25 Accordingly, the FRS introduces a more specific definition of an accounting policy. As defined in the FRS, accounting policies are concerned with the recognition and presentation of assets, liabilities, gains, losses and changes to shareholders' funds, and with the selection of measurement bases for those items. However, methods used to arrive at a monetary amount corresponding to the measurement basis selected are in the nature of estimates rather than accounting policies. Accordingly, the FRS defines such methods as 'estimation techniques' and makes clear that they are not accounting policies.
- 26 The Board believes that this approach will make it easier to distinguish between a change of accounting policy and a change of accounting estimate. Where an accounting change leads to an asset, liability or other item being measured in a different way, an important question is whether this involves a change of measurement basis—ie whether a different attribute of the item is being measured. If so, it will be a change of accounting policy. Otherwise, it will be merely a change of estimation technique.

*FRS 3 'Reporting Financial Performance'*

- 27 Some respondents suggested that material relating to prior period adjustments included in FRS 3 'Reporting Financial Performance' might more appropriately be included in an FRS developed from FRED 21. However, in June 1999 the Board published a Discussion Paper entitled 'Reporting Financial Performance: proposals for change', which included a proposal that might affect the circumstances in which errors in earlier financial statements would lead to prior period

adjustments. Accordingly, while the Board agrees that, in the longer term, it may be appropriate for material relating to prior period adjustments to be included with the material in this FRS, it does not believe it is appropriate to move material from FRS 3 at present.

***Adopting and changing accounting policies***

*Requiring adoption of the most appropriate accounting policies*

- 28 The standard accounting practice required by SSAP 2 was concerned, explicitly, only with disclosure. Nevertheless, the explanatory note to SSAP 2 described accounting policies as being those “judged by business enterprises to be most appropriate to their circumstances”, while the definition of an enterprise’s accounting policies referred to them being “best suited to present fairly its results and financial position”. The FRS makes explicit that an entity should adopt those accounting policies judged to be the most appropriate to its particular circumstances for the purpose of giving a true and fair view.
- 29 A minority of respondents suggested that an FRS developed from FRED 21 should require only that accounting policies be appropriate, rather than most appropriate. The Board rejected this as being a step backwards from the position under SSAP 2. Other respondents suggested that the approach set out in the FRED would be more onerous than SSAP 2; however, although the FRS uses the phrase “most appropriate” whereas the SSAP sometimes used the phrase “best suited”, the Board believes both phrases reflect the same underlying objective.



- 30 In addition, some respondents expressed concern that the approach taken in the FRED might create difficulties for directors and auditors, particularly if similar entities adopt different accounting policies or if an entity's choice of accounting policies is subsequently challenged. The Board does not believe that such difficulties should arise. The FRS makes clear that the most appropriate accounting policies are to be judged in the context of an entity's particular circumstances; different policies may be most appropriate in different circumstances. Further, the choice of accounting policies is only one of many judgements involved in the preparation of financial statements. For any such judgement it may become clear, with the benefit of hindsight, that a different judgement would have been more appropriate, but that does not invalidate an earlier judgement arrived at in good faith. In particular, where an entity changes accounting policies it does not follow that its former accounting policies were in some sense wrong, or that financial statements prepared under those former policies did not give a true and fair view.
- 31 Finally, a small number of respondents thought the FRED was proposing that an entity should disregard or overrule the requirements of other accounting standards and legislation in determining the most appropriate accounting policies. As explained below, this was not the case; however, the FRS has been amended to avoid any confusion in this respect.

*Identifying the most appropriate accounting policies*

- 32 In identifying the accounting policies to be followed, directors need to ensure that an entity complies with the provisions of other accounting standards and specific statutory requirements. This will often mean that the policies available to an entity are restricted, and on occasions there may be only one acceptable accounting policy to be followed. However, where

more than one policy is acceptable the FRS requires the entity to adopt whichever of those policies is judged to be the most appropriate.

- 33 The Board acknowledges that the judgement of which accounting policy is most appropriate for the purpose of giving a true and fair view will to an extent be subjective, since it must take into account an entity's particular circumstances. Nevertheless, it is important that different entities have the same goal in sight when selecting policies, which is that they should reflect, as far as is practicable, the effects of transactions and other events on the entity's financial performance and financial position in an appropriate manner. Accordingly, the FRS specifies objectives and constraints that an entity should take into account in judging which accounting policies are most appropriate.
- 34 The FRS does not prescribe measurement bases, but some examples of changes to accounting policies and to estimation techniques are set out in Appendix I. However, some respondents suggested that the proposals in FRED 21 implied that the Board was seeking to require entities to make greater use of current values and to restrict legitimate options to report assets at historical cost. This was not the Board's intention, nor does it believe that this will be the effect of the FRS. Where it is permissible to report an asset on either a historical cost or a current value basis, as under FRS 15 'Tangible Fixed Assets' for example, an entity will judge which of those policies is most appropriate to its particular circumstances. Factors to be taken into account will include, among others, the relevance of the information to users, comparability with other entities and also the relative costs and benefits of the different policies. Moreover, different judgements may be likely depending on the nature both of the asset and of the reporting entity.

*Changing accounting policies*

- 35 The FRS requires accounting policies to be reviewed regularly to ensure that they remain the most appropriate to an entity's particular circumstances, and a new accounting policy to be implemented if judged more appropriate. Although the objectives and constraints to be considered by an entity will not change, the relative merits of a particular accounting policy, and of the associated measurement basis, may change over time.
- 36 Many respondents expressed the view that it is unhelpful to users for an entity to change accounting policy too frequently, and that the FRED had placed insufficient emphasis on this longer-term aspect of comparability. The Board agrees that there is a balance to be achieved in this regard. Accordingly, paragraph 49 of the FRS makes clear that, in judging whether a change of accounting policy is appropriate, an entity will assess whether the benefit to users arising from the new policy outweighs the corresponding disadvantages.

***Disclosures: estimation techniques***

- 37 In developing the FRED, the Board considered whether disclosures should be required in respect of estimation techniques. Very often, such disclosures will not be necessary because it is sufficient for users to understand the measurement basis that is being reflected. This is particularly the case where an amount may be estimated with reasonable certainty, ie whichever estimation technique is used the amount estimated will fall within a relatively narrow range. Accordingly, the FRED did not propose to require disclosures in respect of an estimation technique merely because it produces an amount that is material.

- 38 Instead, the FRED proposed that a description of an estimation technique should be provided where the use of that technique is material. It explained that this would be the case where another estimation technique, other than that adopted, is also relevant and reliable and, had that other estimation technique instead been adopted, the figures presented in the financial statements would have been materially different. Where a range of methods and estimates would be acceptable, the entity would need to consider the range of amounts resulting from using those different estimates and methods.
- 39 Many respondents disliked this approach, objecting that it was too complex and that it was onerous to expect entities to assess amounts using many different estimation techniques. Some respondents suggested that disclosures should be required in respect of all estimation techniques used for material items. However, the Board believes that this alternative approach would also be onerous, in that many estimation techniques are used in the preparation of financial statements, and that it would result in users being swamped with irrelevant information.
- 40 Estimation techniques are used where there is uncertainty over the monetary amount to be associated with the measurement basis chosen for a particular item. The Board believes that information about estimation techniques should be provided where that uncertainty is significant in the context of the accounts as a whole. Nevertheless, it accepts the criticisms of the FRED's proposals, and has reconsidered how this objective should be encapsulated. Accordingly, the FRS instead focuses on the degree to which judgement is needed in applying whichever estimation technique has been chosen, and the sensitivity of the resulting amounts to such judgement.

***FRED 21 Supplement ‘Accounting Policies:  
Compliance with Statements of Recommended Practice’***

- 41 In March 2000, the Board published a Supplement to FRED 21, which proposed additional disclosures where a significant part of an entity’s activities falls within the scope of a Statement of Recommended Practice (SORP). The Supplement’s proposals were well received by most respondents, and they have been reflected in the FRS. However, respondents raised a number of practical issues, particularly relating to the scope of SORPs and to possible conflicts between SORPs. In response to these, the FRS:
- requires disclosures where an entity’s financial statements fall within the scope of a SORP, rather than where a significant part of its activities falls within the scope of a SORP
  - makes clear that where an entity fails to provide disclosures recommended by a SORP, it should describe those disclosures and explain why they have been omitted
  - emphasises that quantification of a departure from a SORP is not required except in those rare cases where such quantification is necessary for the entity’s financial statements to give a true and fair view.

- 42 In July 2000 the Board issued a Statement 'SORPs: Policy and Code of Practice'. The Code of Practice requires, amongst other things, that a SORP should state its scope by indicating the types of entity to whose financial statements the SORP is intended to apply. However, the Board recognises that some SORPs may need to be updated in order to comply with this requirement. Until that updating has taken place, it may not be possible for an entity to determine whether it falls within the scope of a SORP and, hence, is required to make disclosures under the FRS. Accordingly, those paragraphs of the FRS that relate directly to the Supplement's proposals need not be applied in respect of accounting periods beginning on or before 23 December 2001, though earlier application is encouraged.

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